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FISCAL IMPACT STATEMENT

LS 7834 **NOTE PREPARED:** May 4, 2005
BILL NUMBER: SB 1 **BILL AMENDED:** Apr 29, 2005

SUBJECT: Tax Incentives.

FIRST AUTHOR: Sen. Ford **BILL STATUS:** Enrolled
FIRST SPONSOR: Rep. Turner

FUNDS AFFECTED: X GENERAL **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *Property Tax Abatements:* This bill requires the filing of a personal property return schedule to apply for personal property tax abatement (instead of filing a separate application deduction) and provides that if the township assessor or county assessor does not deny the application, the abatement applies in the amount claimed or in an amount determined by the township assessor or county assessor.

The bill changes the procedure for appealing a denial of a property tax deduction or the alteration of a deduction amount in an economic revitalization area. It also changes the deadline for submitting information updating a taxpayer's compliance with the taxpayer's statement of benefits that is required to obtain a property tax deduction in an economic revitalization area.

Property Tax Investment Deduction: This bill establishes a property tax investment deduction for certain real property development, redevelopment, or rehabilitation that increases assessed value and creates or retains employment. It establishes a similar deduction for the purchase of personal property other than inventory subject to the same conditions and limitation.

Sales Tax Exemption/Credit: This bill expands the sales tax exemption for tangible personal property used by professional motor vehicle racing teams. It exempts a person from 100% of the sales tax on research and development equipment acquired after June 30, 2007. The bill also provides a refund of 50% of the sales taxes paid on transactions involving research and development equipment acquired after June 30, 2005, and before July 1, 2007.

Research Expense Credit: The bill increases the qualified research expense credit from 10% to 15% on the first

$1,000,000 of investment for taxable years beginning after December 31, 2007. It reduces from 15 to 10 the number of years for which a taxpayer may carry over a research expense credit.

Venture Capital Investment Tax Credit: This bill excludes certain debt provided by a financial institution after May 15, 2005, from the definition of "qualified investment capital" that is eligible for the venture capital investment tax credit. It specifies that a business primarily focused on professional motor vehicle racing is eligible for certification as a qualified Indiana business for purposes of the venture capital investment tax credit. The bill increases the total amount of venture capital investment tax credits that may be allowed in a calendar year from $10,000,000 to $12,500,000. It also provides that a taxpayer may not carry over a venture capital investment credit for more than five taxable years following the first taxable year in which the credit is claimed.

Headquarters Relocation Tax Credit: The bill provides that a business that relocates its corporate headquarters to a location in Indiana is entitled to a credit against its state tax liability equal to 50% of the costs incurred in relocating the headquarters.

The bill also makes technical changes.

Effective Date: January 1, 2005 (retroactive); February 9, 2005 (retroactive); May 15, 2005; Upon Passage; July 1, 2005; January 1, 2006; January 1, 2007.

Explanation of State Expenditures: *Venture Capital Investment Tax Credit:* The bill extends eligibility for the Venture Capital Investment Tax Credit to businesses primarily focused on professional motor vehicle racing. This could potentially result in a minimal increase in the number of businesses that annually seek certification for the credit. The Indiana Economic Development Corporation (IEDC) should have sufficient resources to implement this change.

Headquarters Relocation Tax Credit: The bill requires the DOR to make determinations regarding expenditures reportedly made due to a corporate headquarter relocation. The bill requires the DOR to determine whether expenditures made by a taxpayer were the result of the relocation of a corporate headquarters and whether the expenditures would have occurred regardless of the headquarters relocation.

Department of State Revenue (DOR): Generally, the DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the various changes and tax credits contained in this bill. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: The estimated revenue loss to the state from changes in the bill is summarized in the table below:

	FY 2006	FY 2007	FY 2008
R & D Sales Tax Exemption/Credit	($11.4 - $28.3 M)	($12.6 - $31.3 M)	($26.0 - $64.0 M)
Research Expense Income Tax Credit	0	0	(2.2 M)
Venture Capital Investment Tax Credit	(2.5 M)	(2.5 M)	(2.5 M)
Headquarters Relocation Tax Credit	0	Indeterminable	Indeterminable
Total	**($13.9 - $30.8 M)**	**($15.1 - $33.8 M)**	**($30.7 - $68.7 M)**

Sales Tax Exemption for Professional Motor Vehicle Racing Teams: This bill exempts from the state's Sales Tax tangible personal property that:

(1) is leased, owned, or operated by a professional racing team; and
(2) comprises any part of a professional motor racing vehicle, excluding tires and accessories.

The Department of State Revenue (DOR) published *Information Bulletin #67* which states that "a racing vehicle purchased by a professional racing team is exempt from Indiana Sales and Use Tax except for the tires and accessories." Therefore, this bill codifies the DOR's interpretation of the current exemption under IC 6-2.5-5-37.

Research and Development Sales Tax Exemption/Credit: This bill provides a refund of 50% of the Sales Taxes paid on transactions involving research and development equipment for FY 2006 and FY 2007. The bill provides an exemption from 100% of the Sales Tax on research and development equipment beginning in FY 2008.

The 50% refund is estimated to reduce state Sales Tax revenue by approximately $11.4 M to $28.3 M in FY 2006, and $12.6 M to $31.3 M in FY 2007. The exemption that begins in FY 2008 is estimated to reduce Sales Tax revenue by approximately $26 M to $64 M in FY 2008. This estimate is based on data obtained from the National Science Foundation (NSF) that describes the total value of industrial research and development performed in Indiana through CY 2000. Based on past R&D expenditures and adjusting for historical growth, it is estimated that in FY2006, Indiana firms will expend a total of approximately $2,944 M on R&D in Indiana. In FY 2007, these expenditures are expected to increase to $2,984 M. Using NSF information on how R&D funds are spent, it is estimated that approximately 14% to 35% of Indiana R&D expenditures would be subject to the state's Sales Tax.

Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

Research Expense Income Tax Credit: The bill clarifies that this credit applies only to Indiana qualified research expenses and gross receipts attributable to Indiana in the calculation of this credit. This bill also increases the credit from 10% to 15% on the first $1,000,000 of investment for tax years beginning January 1, 2008. The bill reduces from 15 to 10 the number of years for which a taxpayer may carry over a research expense credit. The incremental revenue loss from increasing the rate of this credit is estimated to be $1.5 M. However, the increase in the state's liability for this credit could potentially be $2.2 M annually, with $.6 M in liabilities being carried forward each year due to the fact that businesses qualifying for credits may have insufficient tax liabilities to use the credits earned during the taxable year. The potential increase cost of this credit would depend on the frequency and cost of future research activities and income growth of taxpayers making creditable research expenditures. This increase in the amount of credit would affect revenue collections beginning in FY 2008 and years after.

Background: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 81-2004 made this tax credit permanent. This bill will increase the credit to 15% with tax years beginning January 1, 2008.

The Research Expense Credit is available for individuals, corporations, limited liability companies, limited liability partnerships, trusts, or partnerships who have increased research activities conducted in Indiana. The credit is calculated based on the increased expenses a taxpayer incurred over their base year expenditures. The base year expenditures are measured for taxable years beginning after December 31, 1989, and are equal to the federal base amount as defined in the Internal Revenue Code (2001). A taxpayer is not entitled to a carryback or refund, but may carry forward the tax credit for 15 years. The base year expenses may not be less than 50% of the current tax year's qualified research expenses.

Preliminary data on the amount of credits claimed after the changes made by P.L. 242-2002(ss) suggest that approximately $48 M in credits have been *claimed* in the 2003 tax year. This suggests that the base of the potential credits almost doubled over prior levels. However, since there is currently such a large number of suspended returns, DOR is unable to report the level of actual credits *utilized* for tax year 2003, which would indicate the direct and immediate revenue loss from the changes in the rate and base of the credit. A simulation of taxpayers suggests that the increase in the rate from 5% to 10% doubles the potential credits *claimed*, but only 80% of these credits would be *utilized* and 20% of the credits would be carried forward. This simulation also suggested that an increase in the rate of the credit from 10% to 15% on the first $1M investment would increase the credits *claimed* by another $1.5 M, with $0.6M of the credits being carried forward. Tax year 2001 tax return data indicates that almost 89% of individual filers reporting some business net income had income tax liabilities of $3,400 or less. For the same year, 88% of corporate filers had income tax liabilities of $10,000 or less.

A history of the Research Expense Credits taken on the individual and corporate tax returns for the last five years is reported in the table below.

History of Research Expense Credits Utilized				
Tax Year	**Tax Rate**	**Indiv. AGI Credits**	**Corp. Tax Credits**	**Total Credits**
1999	5%	$1.6 M	$25.8 M	$27.4 M
2000	5%	$1.6 M	$18.1 M	$19.7 M
2001	5%	$1.2 M	$21.6 M	$22.8 M
2002*	5%	$1.3 M	$12.3 M *	$13.6 M *
2003*	10%	$2.2 M	$14.0 M *	$16.2 M *
** 2002 & 2003 tax year estimates are preliminary due to a large number of suspended returns.*				

Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment. Assuming this economic impact would not have happened absent this incentive, the actual revenue loss from this credit would be mitigated by the incremental increase in other taxes generated by the research activities.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Venture Capital Investment (VCI) Tax Credit: The bill makes the following changes to the VCI Tax Credit.

(1) The bill increases the annual aggregate limit on VCI credits that may be claimed by investors for venture capital investment in qualified companies. The bill increases the annual credit limit from $10 M to $12.5 M, beginning in calendar year 2005. The potential annual increase of $2.5 M in credits claimed for the period 2005 through 2008 could potentially increase the total cost of the credit by $10 M before it expires. However, the additional fiscal impact depends on action by the IEDC to certify companies for purposes of the credit, and by investors to follow through with creditable investment.

In 2004, 42 companies were designated as qualified to receive venture capital investment for which the investors could claim VCI credits. For 2004, about $16.3 M in credits were committed to these companies based on their proposed investment levels. However, only $10 M in credits could be claimed by investors due to the annual aggregate credit limit set under current statute. At this time, the investors have made sufficient investment in the 42 qualified companies to claim approximately $3.8 M of the 2004 committed tax credits. Under current law, a taxpayer may claim the VCI credits against the State Gross Retail and Use Tax, Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, or Insurance Premiums Tax liability.

(2) The bill limits the carry forward of unused VCI credits to five years. Under current statute, there is no limit the carry forward period. The impact of this change is indeterminable as data is unavailable relating to credit use and carry forward.

(3) The bill extends eligibility for the VCI Tax Credit to businesses primarily focused on professional motor vehicle racing. This provision could potentially increase the number of businesses qualifying for the credit, but would not increase the fiscal impact of the tax credit due to the annual limit on new credits.

(4) The bill excludes certain secured debt financing of financial institutions from qualifying for the VCI Tax Credit. This exclusion would apply to debt financing provided by a financial institution after May 15, 2005, if it is secured by a mortgage or other agreement that establishes a collateral or security position for the financial institution that is senior to collateral or security interests of other investors in the qualified company.

Background: The Venture Capital Investment Tax Credit is a nonrefundable tax credit equal to the lesser of: (1) 20% of qualified investment capital (debt or equity capital) provided to a *qualified Indiana business* during a calendar year; or (2) $500,000. The tax credit is allowed for venture capital investment made from January 1, 2004, to December 31, 2008. Under current law, a taxpayer may claim the credit against the State Gross Retail and Use Tax, Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, or Insurance Premiums Tax liability. While the tax credit is nonrefundable, it may be carried forward to subsequent years. No carryback of the tax credit is allowed. Current statute sets an annual limit equal to $10 M on the total new credits certified by the IEDC for venture capital investment. A taxpayer must provide the venture capital investment to the qualified company within two years. Carryover credits claimed in a taxable year are not counted toward the $10 M annual maximum.

Headquarters Relocation Tax Credit: The tax credit could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, the Financial Institutions Tax, and the Insurance Premiums Tax when a business undertakes an eligible headquarters relocation to Indiana. The potential fiscal impact of this credit is indeterminable. Any resultant fiscal impact could commence in FY 2007 depending upon when qualified relocations might occur.

Background: The bill establishes a nonrefundable tax credit against a taxpayer's AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for relocating a corporate headquarters to Indiana. The credit is equal to 50% of the taxpayer's relocation costs in a given tax year. The net revenue impact of the Headquarters Relocation Tax Credit depends on the extent that tax collections on headquarters employees and other taxable activities attributable to the headquarters is less than or exceeds the credits claimed by the business. However, if the headquarters relocation had occurred in the absence of the tax credit, the net impact would be the total credits claimed by the business. Data analysis by researchers at the Chicago Federal Reserve Bank indicates that two corporate headquarters moved into the Indianapolis metropolitan statistical area from 1990 to 2000. This data analysis, however, was not performed on a statewide basis or on any other distinct metropolitan area in Indiana. In addition, the analysis focused only on public companies with worldwide employment of at least 2,500.

To qualify for the tax credit, the taxpayer must relocate the corporate headquarters of an "eligible business" from a location outside of Indiana to an Indiana location. The corporate headquarters building or buildings must contain the principal offices of the principal executive officers of the eligible business. An "eligible business" must: (1) be engaged in either interstate or intrastate commerce; (2) maintain a corporate headquarters at a location outside Indiana; (3) have not previously maintained a corporate headquarters at a location in Indiana; (4) have had annual worldwide revenues of at least $500 M in the year previous to the year of application for the tax credit; and (5) commit contractually to relocating its corporate headquarters to Indiana.

The credit is not refundable. Credits in excess of the taxpayer's state tax liability may be carried over for nine succeeding years. The taxpayer is not allowed to carry back any unused credit. In addition, the credit is not allowed to reduce a qualifying taxpayer's state tax liability below the amount paid by the taxpayer in the tax year immediately preceding the year the taxpayer first incurred relocation costs. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity.

The credit is effective beginning in tax year 2007. Revenue from the corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. The revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Property Tax Investment Deduction: The state levies a small tax rate on property for State Fair and State Forestry. Any change in the tax base would change the amount received from this tax.

If there is an increase in investment because of the changes in this bill, the new property would, at some point, be placed on the tax rolls and the State Fair and State Forestry funds would receive increased revenues. If the investment had been made with or without the deduction, then increased revenues to the State Fair and State Forestry funds would be foregone until the property is placed on the tax rolls.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Property Tax Abatements:* Under current law, taxpayers annually file a deduction application with the county auditor for personal property abatements. The county auditor must review the application and may request assistance from the township assessor. The county auditor must then approve, deny, or alter the deduction amount. Taxpayer appeals are currently made to the county court.

Under this provision, taxpayers would instead file a deduction schedule with the township assessor as part of the personal property return. The township assessor would forward the schedule to the county auditor and county assessor. Both the county and township assessors would be permitted to review and deny or alter the amount of the deduction before March 1 of the following year. The county auditor would be required to apply the full or altered (if altered by an assessor) deduction amount if the claim is not denied before March 1. If either assessor denies or alters the claim, then the assessor taking the action would notify the county auditor and the taxpayer. The taxpayer may appeal a change or denial within 45 days by requesting a preliminary conference with the appropriate assessor. Appeals would then follow the usual appeal process for property tax-related matters.

Under current law, taxpayers must file a deduction application with the county auditor for real property abatements in the assessment year in which the added AV takes effect. The county auditor may ask the township assessor to review the application. The county auditor must make the appropriate deduction. Taxpayer appeals are currently made to the county court. This provision would permit a taxpayer to appeal a change or denial within 45 days by requesting a preliminary conference with the county auditor. Appeals would then follow the usual appeal process for property tax-related matters.

Property Tax Investment Deduction: Under this provision, the increase in assessed value (AV) from certain real and personal property additions would qualify for property tax deductions over a period of three years. The deduction would apply if the property owner creates or retains jobs because of the project.

The deduction would apply to the following property that is first assessed on March 1, 2006, 2007, 2008, or 2009:

1. Real property AV that is added due to development, redevelopment, or rehabilitation; and

2. Personal property purchased by the owner that was never before used by its owner in Indiana.

The real property deduction would not be available for the following facilities: golf courses, country clubs, massage parlors, tennis clubs, racetracks, package liquor stores, residential property unless it is low income or in a residentially distressed area, or facilities for skating, racquet sport, hot tubs, suntans, retail food and beverage sales, automobile sales or service, or other retail facilities.

The deductions for both real and personal property would equal 75% of the AV increase in the first assessment year, 50% in the second year, and 25% in the third year. Each property owner would be limited to $2M AV in real property deductions plus $2M AV in personal property deductions within each county.

Taxpayers would not be permitted to claim more than one deduction for which the project may qualify. So, for example, a taxpayer could not claim both a regular abatement and this deduction on the same property. Taxpayers who are located in a TIF area would not be eligible for the deduction.

The real property deduction is much like the existing 3-year abatement for real property. The personal property deduction differs from the current personal property abatement in that the current abatement is available only for manufacturing, research, and logistic equipment. The proposed deduction has no such requirement on the use of the equipment. The deduction percentages for both the proposed real and personal property deductions are lower than the current abatement percentages.

Taxpayers seeking the real property deduction would have to file a claim for the deduction with the township assessor. Taxpayers seeking the personal property deduction would have to claim the deduction on their personal property tax return.

The investment deduction would slow the growth of both real and personal property AV for property that would have been put in place regardless of the deduction. If there is an increase in development because of the availability of the deduction, then the new property would provide for an increase in the tax base.

<u>Tax shifts between existing and new or rehabilitated property.</u> Generally speaking, the addition of assessed value to the tax base provides a tax shift from existing property to new property by spreading the tax levy over a larger tax base. The proposed deduction would slow this shift as it pertains to property that would have been put in place regardless of the deduction. This shift could also be accelerated if the availability of the deduction results in an increase in development.

<u>Tax shifts between property classes</u>. The varying rates at which assessed values in each class of property grow in relation to each other determine each class's relative share of the tax burden. The extent to which the growth rate for businesses is affected by this bill will determine whether any tax shifts will occur between classes. Regarding property that would have been put in place regardless of the deduction, this bill would shift some taxes from businesses to other property classes. However, any increase in development that is spurred by the deduction would shift taxes from non-business property classes to businesses.

<u>State Agencies Affected:</u> Indiana Economic Development Corporation; Department of Local Government Finance; Department of State Revenue.

<u>Local Agencies Affected:</u> Township and county assessors; County auditors.

Information Sources: National Science Foundation, *Survey of Industry Research and Development*; Department of State Revenue; Lynette Curtis, IEDC, (317) 232-8898; State Budget Agency. *Where the Headquarters are - Evidence from Large Public Companies 1990-2000;* Federal Reserve Bank of Chicago, Working Paper 2003-35.

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